

STATE OF MONTANA COMPLIANCE SUPPLEMENT FOR AUDITS OF LOCAL GOVERNMENT ENTITIES	REF: C/T-6
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PROGRAM/SUBJECT: Cities and Towns - Procurement, Bid Letting, and Contracts	

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

CERTAIN CONTRACTS TO BE SUBMITTED TO VOTERS:

1. Compliance Requirements:

- No contract may be let pursuant to MCA 7-5-4302, pertaining to competitive bidding requirements, (see Compliance Requirement No. 3 below) that extends over a period of 5 years or more without first submitting the question to a vote of the electors of the city or town. (MCA 7-5-4304)
 - The following are the exceptions to submitting the contract to the voters:
 1. a contract for solid waste management system as defined in MCA 75-10-103, which may not exceed 10 years; or
 2. obligations issued pursuant to MCA 7-7-4104, which may include bonded indebtedness, note indebtedness, a lease, a lease-purchase agreement, an installment purchase contract, or other legal forms (see following Compliance Requirement).
- (MCA 7-5-4304)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

CERTAIN CONTRACTS TO BE SUBMITTED TO VOTERS - continued:

Suggested Audit Procedure:

- Review contract documents and determine that any contracts let pursuant to MCA 7-5-4302 do not extend over a period of 5 years or more (taking into consideration the exceptions noted above). If the contracts exceed the allowable term, verify through a review of minutes of council meetings and other city or town documents that the electors of the city or town approved the extended term of the contract.

INCURRENCE OF CERTAIN OBLIGATIONS BY MUNICIPALITY:

2. Compliance Requirement:

- A municipality may enter into or incur an obligation, including a lease-purchase agreement or an installment purchase contract, for any public or governmental purpose including the purposes set forth in MCA 7-7-4101. The obligation may be in the form of bonded indebtedness, note indebtedness, a lease, a lease-purchase agreement, an installment purchase contract, or other legal form. An obligation may be issued only if:
 - a. the principal amount of the obligation does not exceed 10% of the general fund budget of the municipality in each of the 2 immediately preceding fiscal years;
 - b. at the time the obligation is to be incurred, the debt services in the current or in any future fiscal year on the obligation and any other outstanding obligation issued pursuant to this section do not exceed 2% of the revenue deposited in the general fund of the municipality in each of the 2 immediately preceding fiscal years; and
 - c. the term of the obligation does not exceed 20 years.
 (MCA 7-7-4104)

Suggested Audit Procedure:

- Review obligations entered into under the provisions of MCA 7-7-4104, and determine that the conditions required by that section of law, as outlined above, have been adhered to.

BIDDING - ADVERTISEMENT REQUIRED:

3. Compliance Requirements:

- Advertised bids are required before the city or town council enters into any contracts for the:
 1. purchase of any automobile, truck, other vehicle, road machinery, other machinery, apparatus, appliances, equipment, or materials or supplies or for construction, repair, or maintenance in excess of \$50,000. (MCA 7-5-4302(1)) In

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BIDDING - ADVERTISEMENT REQUIRED - continued:

3. Compliance Requirements - continued:

lieu of advertised bids, these same items and buildings costing \$50,000 or less may be purchased at public auction. (MCA 7-5-4310)

2. lease of equipment with an option to purchase at the end of the lease term. (AGO #78, Vol. 41) The total amount of the lease payments, together with the purchase option price, should be considered when determining whether the agreement is subject to the bidding provision of MCA 7-5-4302, as noted in 1 above.

(Note: A local government unit with self-government powers cannot supersede by the passage of a resolution or ordinance the competitive bidding requirements set forth in MCA 7-5-4302. (AGO #175, Vol. 37))

- The following are the exceptions to the bidding requirements:

1. contracts for professional, technical, engineering, and legal services (MCA 7-5-4301);

(Note: A contract for the employment of a construction manager that calls only for the application of the contractor's technical expertise and experience in a supervisory capacity and does not involve the procurement of supplies or actual construction is a contract for professional and technical services. (AGO #175, Vol. 37))

2. purchases necessitated by emergencies, as defined in MCA 7-5-4303(1);
3. purchases of supplies or equipment from government agencies when the purchase can result in a substantial savings to the city or town, and when there is sufficient budget for the purchase. (MCA 7-5-4303(2))
4. Solicitation and award of an investment grade energy audit or energy performance contract pursuant to Title 90, Chapter 4, Part 11, or to the construction or installation of conservation measures pursuant to the energy performance contract. (MCA 7-5-4315)

(Note: See Compliance Requirement #16 "Local Government Energy Performance Contracts", below)

Suggested Audit Procedures:

- As part of expenditure testing, review minutes of the council meetings and bid files to determine that applicable competitive bidding requirements were followed for those transactions which exceed the above dollar amounts.
- Review any lease/purchase contracts and determine the total amount of the lease payments and the purchase option price. If the sum of these amounts exceeds the limits for which competitive bidding is required, verify that the lease/purchase agreement was subject to the applicable competitive bidding requirements.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BIDDING - GAS TAX FUNDS:

4. Compliance Requirement:

- If a city or town contracts for construction, reconstruction, maintenance or repair of city or town streets or alleys costing in excess of \$25,000 to be paid with gasoline tax funds, the funds must be disbursed to the lowest responsible bidder according to applicable bidding procedures. (MCA 15-70-101(5))

(Note: The governing body of a town or third-class city, as defined in MCA 7-1-4111, may each year expend no more than 25% of the funds allocated for the purchase of capital equipment and supplies to be used for the maintenance and repair of streets and alleys. **Effective July 1, 2007** – The governing body of a town or third-class city may place all or a part of the 25% in a restricted asset account within the gas tax apportionment fund that is carried forward until there is a need for the expenditure. (MCA 15-70-101(4))

(See TRAN-1 “Gasoline Tax Apportionment” for additional information)

Suggested Audit Procedure:

- Select expenditures of gasoline tax funds which are in excess of \$25,000. If the expenditures are for construction, reconstruction, maintenance, or repair of city or town streets or alleys, review minutes of the council meetings and bidding files to verify that the contracts were awarded to the lowest responsible bidder according to applicable bidding procedures.

DIVIDING CONTRACTS PROHIBITED:

5. Compliance Requirement:

- Public work or construction projects for which competitive bidding is required may not be divided into several contracts to circumvent the competitive bidding requirements. (MCA 7-5-4305)

(Note: In reviewing case notes the Department identified a court case where the court found sufficient substantial evidence to sustain guilty verdicts and judgment against three County Commissioners for official misconduct committed by failing to perform a mandatory duty of advertising a county road contract for bid and by knowingly performing the forbidden act of dividing a single road contract into parts to circumvent bidding requirements. Although the case is specific to a county, the same requirements are in the above statute relating to cities and towns. (St. v. DeGeorge, 173 M 35, 566 P2d 59 (1977)))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

DIVIDING CONTRACTS PROHIBITED - continued:

Suggested Audit Procedure:

- Determine, through expenditure testing and a review of the minutes of council meetings, that no contract was divided into several parts to circumvent the competitive bidding requirements.

BID SECURITY DEPOSIT:

6. Compliance Requirement:

- Bids for public contracts must be accompanied by a bid security deposit in the form of cash; cashier's check, certified check, bank money order, or bank draft drawn and issued by a federally chartered or state-chartered bank insured by the federal deposit insurance corporation; or a bid bond, guaranty bond, or surety bond executed by a surety corporation authorized to do business in Montana. (MCA 18-1-201 through 18-1-203)

(**Note:** The public authority soliciting or advertising for bids may not require that a bid bond, guaranty bond, or surety bond provided for in 18-1-203(1)(a)(iii) be furnished by a particular surety company or by a particular insurance producer for a surety company.)

Suggested Audit Procedure:

- Review the minutes of governing body meetings, and the requests for bids and bidding files of selected projects, and verify that a bid security deposit, in some form, accompanied all bids.

AWARDING PUBLIC CONTRACTS:

7. Compliance Requirements:

- Public contracts for construction, repair or public works must be awarded to the lowest responsible bidder without regard to residency, except for an "Alternative Project Delivery Contract" as provided in Title 18, Chapter 2, Part 5, MCA. However, a resident bidder must be allowed a preference on a contract against the bid of any nonresident bidder from any state or country that enforces a preference for resident bidders. The preference given to resident bidders of this state must be equal to the preference given in the other state or country. (MCA 18-1-102)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

AWARDING PUBLIC CONTRACTS - continued:

7. Compliance Requirements - continued:

- A public contract for the purchase of goods must be let to the lowest responsible bidder without regard to residency. However, a resident must be allowed a preference on a contract against the bid of a nonresident if the state or country of the nonresident enforces a preference for residents. The preference given to resident bidders of this state must be equal to the preference given in the other state or country. (MCA 18-1-102)

(**Note:** The Common Rule (Section _36(c)(2)) prohibits the use of statutorily or administratively imposed in-state or local geographical preferences in the evaluation of bids or proposals for federally-funded contracts, except in those cases where applicable federal statutes expressly mandate or encourage geographic preference.)
[Government-wide guidance for administering grants and cooperative agreements to States and local governments is contained in the OMB Circular A-102 Common Rule (a.k.a. Grants Management Common Rule), which was codified by each Federal funding agency in its title of the *Code of Federal Regulations*. The Common Rule section numbers are referred to without the Federal agency's part number (e.g., §_36 would refer to the same section in all agency regulations). This allows auditors to refer to the same section numbers when discussing administrative issues with different Federal funding agencies. The Codification of Government-wide Grants Requirements by Department can be accessed via this web site:
<http://www.whitehouse.gov/omb/grants/chart.html>]

- The request for bids must require that if the bidder is awarded the contract, the bidder will enter into a formal contract and give a good and sufficient bond to secure the performance of the terms and conditions of the contract. (MCA 18-1-202(1)(a) and 18-2-201)

(**Note:** This faithful performance bond requirement may be waived for building or construction projects that cost less than \$50,000. (MCA 18-2-201(4)))

Suggested Audit Procedures:

- Review the minutes of governing body meetings, and the requests for bids and bidding files of selected projects.
- Determine that every contract subject to bidding is let to the lowest bidder as discussed above.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

AWARDING PUBLIC CONTRACTS - continued:

Suggested Audit Procedures - continued:

- Determine if residency preference was allowed in the awarding of the contract on any project or for the purchase of goods. If allowed, verify that the preference met the provisions of MCA 18-1-102. If the selected projects were federally funded, verify that no residency preference was allowed, unless expressly permitted by relevant federal statutes.
- Verify that the individuals or firms to whom contracts were awarded were required to provide performance bonds, unless the bond requirement was waived as provided by statute.

FEDERAL INFORMATION RETURNS:

8. Compliance Requirement:

- The entity must report on a Federal Information Return, Form 1099-MISC, all payments of \$600 or more which the entity makes during a calendar year to anyone, other than a corporation or tax-exempt organization, who is not an employee. (U.S. Internal Revenue Service Codes)

(**Note:** The following are some examples of payments to be reported on Form 1099-MISC. For a complete list, contact the IRS:

Professional service fees, such as fees to attorneys (including corporations), accountants, architects, contractors, subcontractors, etc.

Payments by attorneys to witnesses or experts in legal adjudication.)

Suggested Audit Procedure:

- As part of expenditure testing, determine that the entity had filed a Form 1099-MISC for each payee who was not a corporation or tax-exempt organization to which the entity had paid \$600 or more for contracted services during the calendar year.

INSTALLMENT CONTRACTS – LENGTH OF TERM:

9. Compliance Requirement:

- The city or town may enter into installment contracts for a purchase in excess of \$4,000 over a period of not more than 10 years if, at the time of entering into the contract, there is an unexpended balance of appropriation in the budget for the then-current fiscal year available and sufficient to pay for the portion of the contract price payable during the then-current fiscal year. (MCA 7-5-4306)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

INSTALLMENT CONTRACTS – LENGTH OF TERM - continued:

Suggested Audit Procedure:

- Review contract documents for installment purchases to determine that the purchase cost was at least \$4,000 and that the installment period does not exceed 10 years.

PRINTING CONTRACTS:

10. Compliance Requirement:

- The city or town council has power to provide for the city or town printing. The contract for city or town printing must be let annually to the lowest bidder. (MCA 7-5-4108)

Suggested Audit Procedure:

- Review the minutes of the board meetings and the bidding files for contracts for printed forms and materials. Verify that contracts for the city or town printing were awarded annually to the lowest bidder.

CONFLICT OF INTEREST:

11. Compliance Requirements:

- The mayor, any member of the council, any officer, or any relative or employee thereof may not be interested, directly or indirectly, in the profits of any contract entered into by the council while the officer is in office.
(MCA 7-5-4109 & 2-2-201)
- The following are exceptions to the conflict of interest requirements
 1. contracts awarded on competitive bidding procedures,
 2. contracts awarded because of certain geographic restrictions,
 3. merchandise sold to the highest bidder at public auctions, and
 4. investments or deposits in financial institutions that are in the business of loaning or receiving money.
(MCA 2-2-201, and AGO #28, Vol. 40)
- A specific waiver of conflict of interest is allowed under certain circumstances after a public hearing. (MCA 7-5-4109(2))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

CONFLICT OF INTEREST - continued:

11. Compliance Requirements - continued:

(**Note:** A public officer or public employee shall, prior to acting in a manner that may impinge on public duty, including the award of a permit, contract, or license, disclose the nature of the private interest that creates the conflict. The public officer or public employee shall make the disclosure in writing to the commissioner of political practices, listing the amount of private interest, if any, the purpose and duration of the person's services rendered, if any, and the compensation received for the services or other information that is necessary to describe the interest. If the public officer or public employee then performs the official act involved, the officer or employee shall state for the record the fact and summary nature of the interest disclosed at the time of performing the act. (MCA 2-2-131))

Suggested Audit Procedure:

- Determine, through a review of the minutes of the council meetings and through expenditure testing, that no member of the council or other designated individual has any apparent improper interest in any city or town contract, as set forth in MCA 2-2-201 and 7-5-4109.

RETAINAGE FEE FOR PUBLIC CONTRACTS:

12. Compliance Requirement:

- The maximum retainage applied to construction contracts may not exceed 5% if the contractor is performing by the terms of the contract. (**Note:** Retainage means the ratio, in percent, of funds retained to the total amount to be paid to the contractor by the government entity) (MCA 18-2-316)

Suggested Audit Procedure:

- Review construction contracts entered into for the period under audit, and determine through a review of the contracts, the minutes of the governing body, and an examination of expenditures, that the city or town did not withhold as retainage more than 5% of the contract amount or claim amount that the construction contractor submitted to the governing body for payment.

ACCEPTANCE AND FINAL PAYMENT ON CONSTRUCTION CONTRACTS:

13. Compliance Requirement:

- A government entity that enters into a contract for the construction of a building shall, unless otherwise provided by law or the contract and within 10 days after a request by the construction contractor for final acceptance, decide whether or not to make final

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ACCEPTANCE AND FINAL PAYMENT ON CONSTRUCTION CONTRACTS – cont.:

13. Compliance Requirement - continued:

acceptance. Within 30 days after final acceptance by the government entity, the government entity shall make the final payment of the contract price specified in the contract to the other party to the contract.

(**Note:** “Final acceptance” means the government entity's acceptance of the construction of a building by the contractor upon certification by the architect, project engineer, or other representative of the government entity of final completion of the building)
(MCA 18-2-306)

Suggested Audit Procedures:

- Review the construction files to determine that the city or town and the construction contractor complied with the above compliance requirements. The file should contain a copy of the request from the construction contractor for the city or town to make final acceptance of the construction of a building. Unless otherwise provided by law or the contract and within 10 days after a request for final acceptance, the file should document the formal decision from the architect, project engineer, or other representative of the governmental entity as to whether or not the government will make final acceptance.
- Review the construction files and expenditures to determine whether the contract price was paid in full within 30 days after final acceptance by the government entity.

ARCHITECTURAL, ENGINEERING, AND LAND SURVEYING SERVICES:

14. Compliance Requirements:

- The legislature established a state policy that governmental agencies, including cities and towns, must publicly announce requirements for architectural, engineering, and land surveying services and negotiate contracts for such professional services on the basis of demonstrated competence and qualifications for the type of professional services required and at fair and reasonable prices. (MCA 18-8-201)
- Each government shall publish in advance its requirement for professional services. The announcement must state concisely the general scope and nature of the project or work for which the services are required and the address of a representative of the government who can provide further details. A government may comply with this section by:

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ARCHITECTURAL, ENGINEERING, AND LAND SURVEYING SERVICES – cont.:

14. Compliance Requirements - continued:

- (1) publishing an announcement on each occasion when professional services provided by a licensed professional are required by the government; or
 - (2) announcing generally to the public its projected requirement for any category or type of professional services.

(MCA 18-8-203)
- In the procurement of the above professional services, the government may encourage firms engaged in the lawful practice of their profession to submit annually a statement of qualifications and performance data. The government shall evaluate current statements of qualifications and performance data on file with the government, together with those that may be submitted by other firms regarding the proposed project, and conduct discussions with one or more firms regarding anticipated concepts and the relative utility of alternative methods of approach for furnishing the required services. The government shall then select, based on criteria established under government procedures and guidelines and the law, the firm considered most qualified to provide the services required for the proposed project. The government procedures and guidelines must be available to the public and include at a minimum the criteria specified in 18-8-204(2)(b) as they relate to each firm.

(MCA 18-8-204)
- The government shall negotiate a contract with the most qualified firm for the above professional services at a price which the government determines to be fair and reasonable. In making its determination, the government shall take into account the estimated value of the services to be rendered, as well as the scope, complexity, and professional nature thereof. If the government is unable to negotiate a satisfactory contract with the firm selected at a price the government determines to be fair and reasonable, negotiations with that firm must be formally terminated and the government shall select other firms in accordance with 18-8-204 and continue as directed in this section until an agreement is reached or the process is terminated.

(MCA 18-8-205)
- This part need not be complied with by a government when the contracting authority makes a finding in accordance with this or any other applicable law that an emergency requires the immediate execution of the work involved. This part does not relieve the contracting authority from complying with applicable law limiting emergency expenditures.

(MCA 18-8-211)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ARCHITECTURAL, ENGINEERING, AND LAND SURVEYING SERVICES – cont.:

14. Compliance Requirements - continued:

- Cities and towns securing architectural, engineering, and land surveying services for projects for which the fees are estimated not to exceed \$20,000 may contract for those professional services by direct negotiation. (MCA 18-8-212)
- No agency may separate service contracts or split or break projects for the purpose of circumventing the provisions of Title 18, Chapter 8, Part 2, MCA. (MCA 18-8-212)

Suggested Audit Procedure:

- Review the construction and bid files to determine if the city or town entered into any contracts for architectural, engineering, and land surveying services. If so, determine whether the contract was let in accordance with the statutory requirements outlined above.

ALTERNATIVE PROJECT DELIVERY CONTRACTS

15. Compliance Requirements:

- Alternative project delivery contract means a construction management contract, a general contractor construction management contract, or a design-build contract. (MCA 18-2-501)
- A governing body that uses an alternative project delivery contract shall demonstrate that the governing body has or will have knowledgeable staff or consultants who have the capacity to manage an alternative project delivery contract
- Prior to awarding an alternative project delivery contract, the governing body shall make a determination, in writing, that the proposal meets at least two of the sets of criteria described in (a) through (c) below, and that the proposal meets the provisions of (d). MCA 18-2-502
 - (a) The project has significant schedule ramifications and using the alternative project delivery contract is necessary to meet critical deadlines by shortening the duration of construction.
 - (b) By using an alternative project delivery contract, the design process will contribute to significant cost savings.
 - (c) The project presents significant technical complexities that necessitate the use of an alternative delivery project contract.
 - (d) Using an alternative project delivery contract will not encourage favoritism or bias in awarding the contract or substantially diminish competition for the contract.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ALTERNATIVE PROJECT DELIVERY CONTRACTS - continued

15. Compliance Requirements - continued:

- The governing body's decision to award an alternative project delivery contract must be based, at a minimum, on:
 - (a) the applicant's history and experience with projects similar to the project under consideration; financial health; staff or workforce that is proposed to be committed to the project; approach to the project; and project costs, and
 - (b) any additional criteria or factors that reflect the project's characteristics, complexities, or goals. (MCA 18-2-503)
- At the conclusion of the selection process, the governing body shall state and document in writing the reasons for selecting the contractor that was awarded the contract. The documentation must be provided to all applicants and to anyone else, upon request. The governing body may compensate unsuccessful applicants for costs incurred in developing and submitting a proposal, provided that all unsuccessful applicants are treated equitably.

Suggested Audit Procedure:

- Review the construction and bid files to determine if the city or town entered into any alternative project delivery contracts. If so, determine whether the contract was let in accordance with the statutory requirements outlined above.

LOCAL GOVERNMENT ENERGY PERFORMANCE CONTRACTS:

16. Compliance Requirements:

- Energy performance contracts are a means by which local government units can achieve energy and water conservation without an initial capital outlay. "Energy performance contract" is defined as a contract between a local government unit and a qualified provider for evaluation, recommendation, and implementation of one or more conservation measures, evaluation of conservation-related cost savings, and a guarantee of cost savings. (MCA 90-4-1101 & 1102)
- A local government may solicit requests for qualifications (RFQ) to enter into an energy performance contract and requests for proposals for investment grade energy audits, and negotiate a contract with the most qualified provider by following the process in MCA 90-4-1104. Alternatively, the local government can avoid the RFQ process by selecting a qualified provider from a pre-qualified list provided by the Montana Department of Environmental Quality's Air, Energy and Pollution Prevention Bureau. (MCA 90-4-1104 & 1105; MACo Newsletter 2/06)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

LOCAL GOVERNMENT ENERGY PERFORMANCE CONTRACTS - continued:

16. Compliance Requirements – continued:

- An investment grade audit serves as a basis for the terms of an energy performance contract. If the local government determines that the energy audit doesn't provide sufficient conservation-related cost savings, it shall pay the cost of the audit and decline to enter into the energy performance contract. If it is determined that the energy audit provides sufficient cost savings, the qualified provider shall provide plans for the proposed conservation measures. The local government may then negotiate the conservation measures to be included in the energy performance contract and enter into the contract. (MCA 90-4-1106)
- The energy performance contract may include the option of payment of the costs of the energy audit and plans provided for proposed conservation measures through project financing. (MCA 90-4-1106)
- The term of an energy performance contract must be a minimum of 3 years and may be up to the useful life of the conservation measures or 20 years, whichever is less. The contract must require the qualified provider to (1) guarantee the cost savings to the extent necessary to pay for the conservation measures, including financing charges incurred over the life of the contract, (2) monitor the costs savings, and (3) prepare an annual report documenting the performance of the conservation measures. (MCA 90-4-1107)
- Payment obligations pursuant to an energy performance contract aren't general obligations of the local government and are collectible only from conservation-related costs savings provided in the energy performance contract and other revenue, if any, pledged in the energy performance contract. (MCA 90-4-1109)

Suggested Audit Procedures:

- Review the construction and bid files and minutes of meetings of the governing body to determine if the city or town entered into any energy performance contracts. If so, determine whether the required processes for the solicitation, selection and negotiations with the qualified provider, as required by State law, were followed.
- Review the energy performance contract and verify that the terms of the contract are in compliance with State law.
- Determine if the city or town has obtained project financing for the energy performance contract. If so, verify that the debt is serviced only from conservation-related savings and any other revenue pledged in the energy performance contract.